Introduction to IFRS 16 and EZLease

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The road to IFRS 16

- Begun in July 2006; joint project of FASB & IASB
- Primary purpose: Put lessee operating leases on balance sheet ✓
- Secondary purpose: Converged standard ☒
- Exposure drafts in 2010 & 2013
- Final release: February 2016
- Implementation: 2019
  - Earlier implementation only if IFRS 15 (revenue recognition) implemented same time or earlier

New terminology

IAS 17	IFRS 16
Gross asset	Right-of-use asset
Capital rate	Discount rate
Tenant allowance	Lease incentives
Contingent rent	Variable lease payments
Executory costs	Nonlease components (new definition)
FAS 13 terminology in EZ13	
Capital lease	Finance lease
Obligation	Liability

New definitions

- Lease: "a contract, or part of a contract, that conveys the right to control the use of identified property, plant, or equipment (an identified asset) for a period of time in exchange for consideration."

  – Exclusions: licensing agreements, biological assets, inventory, exploration or use of minerals, oil & gas, etc., investment property (IAS 40)

New definitions

- Initial direct costs: "Incremental costs of a lease that would not have been incurred if the lease had not been obtained."

Included	Not included
Commissions	Legal fees and tax advice
Incentives to vacate	Overhead expenses, employee pay, depreciation
	Advertising

Nonlease components

- Replacement for executory costs
  - Existing finance leases keep executory costs until expiration or IFRS 16 modification (unless full retrospective application)
- Not capitalized
- "Transfer a good or service to the lessee"
- Practical expedient option not to separate components: everything capitalized
  - Chosen by class of underlying asset

Nonlease components

Qualifies

- Service contract
- Consumables
- Common area maintenance

Does not qualify

- Administrative fees
- Reimbursement of costs (taxes, insurance)

Gross lease: All costs (except maintenance) capitalized
Net lease: Taxes and insurance not capitalized

New accounting methodologies

- Classification:
  - Finance: same initial asset & liability
  - Short term: lease term of <=12 months, including any options (no BPO); = IAS 17 operating
  - Low value: less than approximately $5000; = IAS 17 operating

Expense profiles

Rent payment

Depreciation + interest (finance)

Liability

Net asset
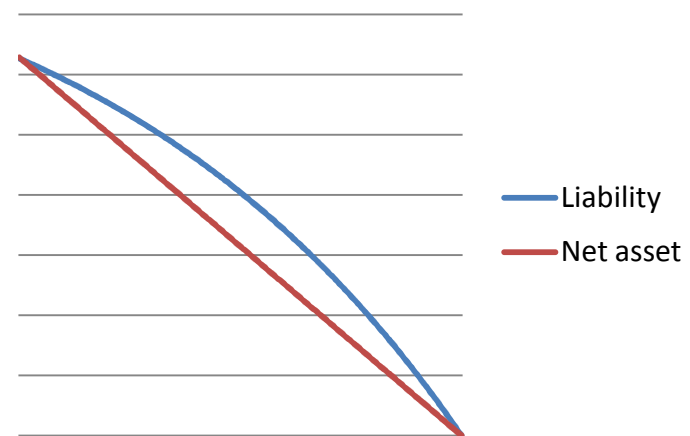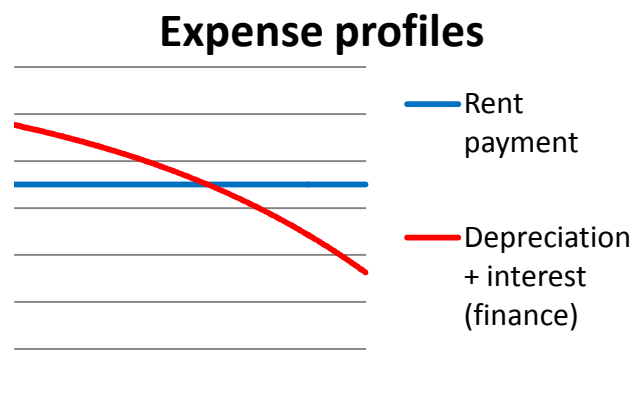
Initial measurement

- **Liability:** PV of rent, *excluding* rent paid on or before first day of lease
  - Expected guaranteed residual payment
  - Include variable lease payments based on index or rate at inception
- Discount rate: implicit rate if known (requires unguaranteed residual and lessor's IDC)
  - Otherwise incremental borrowing rate
- **Right-of-use Asset:** Liability, plus prepaid rent, plus lessee's IDC, minus lease incentives, plus estimated restoration costs

Sale/leaseback transactions

- Sale must meet requirements of IFRS 15
- No substantive repurchase option permitted (even at fair value)

Transition

- Two adoption options (apply to all leases)
  - Retrospective full adoption
    - Implementation coming soon in EZLease
    - Requires incremental borrowing rate at lease inception
    - Will result in charge to equity for difference between asset and liability on previously operating leases
    - Restate comparative years
    - Disclosure of balance sheet adjustments
  - Cumulative catch-up
    - No change to finance leases
    - Operating leases capitalized at application date
    - No restatement of comparative years

Transition

- "Practical expedients" options
  - Keep previous determination of whether or not a contract is a lease (choose for all leases)
- If Cumulative catch-up chosen, options which can be chosen by lease, one or all:
  - Exclude initial direct costs from ROU asset
  - Treat operating leases expiring within 12 months as short term
  - Use hindsight, such as to determine lease term

Transition

- Cumulative catch-up, capitalizing existing operating leases:
  - Liability: PV of remaining rent; only expected guaranteed residual
  - Use incremental borrowing rate at transition date for discount rate
  - ROU Asset: Two options:
    - Recalculate from inception; difference with liability is charge to equity
    - Liability at transition plus deferred & prepaid rent

Revisions

- Discount rate can change
- Variable lease payments dependent on rate or index (CPI, LIBOR, etc.):
  - Lease revised whenever rent is changed
- Other variable payments expensed as incurred
  - % of sales, excess usage, maintenance, …
- Changed asset scope:
  - Increase: New lease (with allocation if concessionary rent)
  - Decrease: Partial termination with gain/loss

Reporting: Disclosures

- Maturity analysis of liabilities
- Depreciation by class of asset
- Interest expense
- Short-term lease expense
- Low-value lease expense
- Variable lease payments (not in liabilities)
- Total cash payments
- Tabular format recommended

Lessor accounting

- Virtually unchanged

- Still finance and operating lease classification

- New definitions (lease, initial direct costs, nonlease components, sale/leaseback) apply

Additional information

- FASB: http://fasb.org/jsp/FASB/Page/BridgePage&cid=1351027207574

- IASB: http://www.ifrs.org/Current-Projects/IASB-Projects/leases-implementation/Pages/IFRS-16-Leases-Implementation.aspx

- Deloitte: https://www.iasplus.com/en/standards/ifrs/ifrs-16

- Ernst & Young: http://www.ey.com/gl/en/issues/ifrs

- KPMG: https://home.kpmg.com/xx/en/home/services/audit/international-financial-reporting-standards/leases.html

- PWC: http://www.pwc.com/gx/en/services/audit-assurance/ifrs-reporting/leases-ifrs-16.html

EZLease demonstration

- Please wait while we switch to a live demonstration of EZLease…

- This slide deck and a recording of the webinar will be at our web site: www.ezlease.net